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János Kornai: *From Socialism to Capitalism*

Budapest 2008: Central European University Press, 240 pp.

János Kornai's latest volume contains seven papers written over the past 20 years. The earliest one was a lecture originally presented in March 1989 in Moscow (Chapter 2), the latest ones were written or published in 2005; one of them (Chapter 6) appears in English for the first time in this volume. The book begins with papers summarising Kornai's work on the political economy of state socialism, the rest belongs to the sub-field known as 'transitology' in the social sciences.

With Oscar Lange, Kornai ranks as the most distinguished and influential political economist of state socialism (or whatever name you want to use for the socio-economic systems that existed after 1917 across the globe from Russia to China, and which still struggle for survival in two countries of the world: North Korea and Cuba).

The most admirable feature of Kornai's work on socialism and post-communism is his consistence. From his wonderful book on 'overcentralisation' (which was his PhD dissertation and appeared in English already in 1959), through his *Rush versus Harmonic Growth* [1972], *Economics of Shortage* ([1980] – the work that I still regard as his most important contribution to institutional economics and for which he was nominated repeatedly for the Nobel Prize, a recognition he would have well deserved), to *The Socialist System* [1992], he built the most comprehensive and convincing analysis of the socialist economic system. His oeuvre is astonishingly coherent. The most remarkable aspect of Kornai's work is not so much that he knew it all along, but rather his ongoing and uncompromising struggle to understand the nature of socialism. He was always ready to learn and re-adjust his explanations as the world of commu-

nism changed. Kornai is one of those rare social scientists who do not pretend he was always right, but all his life made a strenuous effort to find the theory that offers the best fit to the rapidly changing world around him even if it meant to re-think, if necessary, to change his earlier views.

Kornai started his career as a journalist with virtually no training in economics, writing on economic matters during the worst Stalinist times for the central daily newspaper of the Hungarian Communist Party, *Szabad Nép*. As he gradually understood the inefficiencies of what, in Chapter 1 of the present volume, he calls the 'classical system', he became one of the leading journalists expressing their dissent against Stalinism. Kornai abandoned journalism, taught himself economics (even some econometrics), and moved on to develop his formidable, ever deepening critique of socialism. From a devoted communist he became eventually a forceful (though always sober, never dogmatic) advocate of free market economy and pluralist democracy.

His point of departure was the recognition that the classical system is unworkable since it is overcentralised. Publishing a book along those lines in 1957 was a courageous act. Though Kornai's primary aim in his first book and in most of the following ones was primarily *not* to offer recommendations for reforms, but to explain the reasons for the malfunctioning of the socialist economy, the book at least in Hungary (but arguably indirectly in some other socialist countries, like Yugoslavia, pre-1968 Czechoslovakia, and Poland) affected economic policies and serious attempts were made to create more decentralised forms of management.

Kornai soon learned that even radical decentralisation would not be sufficient to correct the inherent problems of communist economies. Since these systems were implemented in economically backward countries, socialism became a strate-

gy of accelerated or 'rush' growth, especially what was known in Marxist political economy as accelerated development of Department I. Well, harmonious growth, a shift from the obsession with the development of heavy industry and mining to the production of consumer goods, infrastructure, to the tertiary sector, is what may be needed. It was the year of the publication of *Rush versus Harmonic Growth* that Kornai invited me and my friend and co-author George Konrád to visit him. In 1971 we had just published an article titled 'Social Conflict of Under-urbanization', and it created a major scandal in Hungary, though I still regard it as one of the better pieces I ever wrote. Like in Kornai's book, we argued that the single most important characteristic of socialism is overinvestment in the productive sector and neglect of consumption, especially infrastructure. This was the first time we met in person: he was kind and generous, but even then, almost 1972, he was highly critical of our attempt in this paper to cast our analysis as a problem of social conflict, in fact, as a problem of class conflict and exploitation. This paper was my first flirtation with Marxism and already in 1972 Kornai was well beyond Marxism and strongly disapproved of it.

In 1972 Konrád and I had just begun our work to identify socialism as a 'redistributive economy' and within a year or two our neo-Polanyian theory was completed. Kornai did not like our term 'redistributive economy', as it reminded him too much of the welfare redistribution of the social democratic welfare state. So he proposed the idea of bureaucratic coordination. Chapter 1 of the current volume summarises his major new arguments. In his view there are two fundamental forms of economic coordination: market and bureaucracy. But it would be wrong to merely see bureaucratic coordination as 'central planning' or a 'command economy'; it is rather a system in which central authorities are linked to enterprise management

by paternalistic ties (and management similarly adopts a paternalistic attitude towards workers). Under these circumstances the central authority is unable to issue mandatory comments. Instead it engages in a plan-bargain with management, which creates soft budget constraints for firms. In market economies firms have hard budget constraints: if they do not produce profit they go under. In socialist systems budget constraints are soft: inefficient firms are bailed out by governments. Since firms can always anticipate bailouts they will constantly make excessive demands, which inevitably lead to chronic shortages. Bureaucratically coordinated economies are economies of shortages. Bingo! That was it: Kornai just produced the most powerful description of the way the socialist economy worked and he accomplished this in a value neutral manner – this book is on par with the best of institutionalist economics, a book indeed worthy of the Nobel Prize.

Chapter 2 of this volume is a courageous lecture Kornai gave at a conference in Moscow in March 1989, well before the USSR and its Communist Party (and the KGB) crumbled. It takes one important step further: if one opts for markets, eventually one will have to accept the domination of private ownership. In his path-breaking 1984 article on 'Bureaucratic and Market Coordination' Kornai already established that there is an 'elective affinity' between bureaucratic coordination and public ownership and market coordination and private ownership, but he did not get as far as to suggest that consequently market reforms will lead to capitalism. Now, Chapter 2 foreshadows what is to come in *The Socialist System*. He is still careful though: Figure 2.1 is still about elective affinity and does not exclude the possibility of mixed economies. But he is more forceful in Chapter 3, first published in 2008, where he not only calls market socialism an illusion, but also arrives at the conclusion that China and Vietnam, given their radical market re-

forms, are for all practical purposes capitalist economies. No more nonsense about 'third ways' or mixed economies, combinations of socialism and capitalism, markets with public ownership or control, or market integration with state redistribution or a mix of those arrangements.

This leads him to argue in Chapter 7 (as far as I can tell he developed this idea already in 1992) that socialism created a 'prematurely born welfare state', which is to be reformed by allowing 'individual freedom of choice' (p. 176) and leaving it to a 'sense of solidarity with those in a disadvantaged position and not capable of paying out of their pocket the costs they will incur if they are in trouble'. I can hardly read this as something other than a UK-US style means-tested temporary 'poor relief' for people in trouble and otherwise market-arranged insurance schemes [Esping-Andersen 1990], with at the same time cut-backs on the excessive expenditures of the 'prematurely born welfare state'.

This is an admirably consistent argument and I am the last one who would or can blame Kornai for re-adjusting his analysis to the changing realities of the world. I like his lack of orthodoxy, his soberness, his realism. With all due respect to his splendid scholarship and acute sense of political realism I do have to express my disagreement though with some of his analysis, especially with some of the conclusions he arrived at in *The Socialist System* and many of the chapters of his current volume.

First of all, I did and still do have my debate with Kornai about the accuracy of 'bureaucratic coordination'. This is far from just a terminological controversy. I believe Kornai does not quite appreciate the Polanyian meaning of redistribution and like earlier critics of my work he did not see the fundamental difference between a redistributively integrated economy (where the 'surplus' – the resources which can be used for investments or turned into profit – is concentrated in central hands before being

redistributed) and the welfare redistribution of capitalist states, which redistributes incomes earned in and determined by markets in the name of social justice and/or solidarity. Bureaucratic coordination does not really capture what the socialist state does, it describes *how* they do it (though doing coordination bureaucratically is hardly a characteristic of capitalist states). If we believe Weber, bureaucracy is the purest form of 'legal-rational domination'. It is present not only in the capitalist state apparatus but also in the large privately owned corporation that Oliver Williamson called 'hierarchy' – but it tells us little about *what* states do. So the crucial question is whether incomes of firms or individuals are determined on price regulating markets, and whether those firms and individuals can dispose with such income (profits), with some limitations imposed on them by usually impersonally defined and universally applied taxes.

If we understand socialism in this sense as a redistributive economy we can see with clarity that socialism *was not only* a *prematurely born welfare state*. In fact, it had *no welfare state at all*. In the East European parlance, economists and politicians quite rightly write about the 'great distributive systems' rather than 'welfare systems'.

It is indeed a common misunderstanding to see the socialist great distributive systems (pensions, health care, funding of education) as identical with what used to be the Scandinavian social democratic universal welfare insurance system [Esping-Andersen 1990]. That system provided as citizenship the right to free universally high quality services. So middle or even higher incomes did not see a need to seek market-based provisions (which otherwise were available to them) and were willing to pay high taxes to receive publicly provided health care, pensions, and education (even tertiary education). I am not arguing here that this was a perfect system, but it had precious little to do how the 'great distrib-

utive systems' worked under state socialism, especially what Kornai referred to under the 'classical system'.

There are three great mythologies about the great distributive systems under socialism, namely that they a) were universal, b) offered equal services, and c) were free. These are the characteristics of social democratic universal welfare insurance schemes as described by Esping-Andersen [1990]. The socialist great distributive systems were hardly universal. They typically were only available to those in state employment. Even those in the cooperative or kolkhoz sector had hardly any access, not to mention the 'criminal', 'hooligan' elements either incapable or unwilling to be gainfully employed. So access to the great distributive systems was a reward for work, not a right earned by citizenship. The services were hardly egalitarian. The higher cadres lived in better housing. They had access to better medical services, shopped in special shops for scarce goods with even more subsidised prices, and their children had higher chances of getting into institutions of tertiary education and even into higher quality primary or secondary schools, etc. And of course all those services were free only for the higher-ups. Poor people could not get public housing, had to build for themselves on the market [Szelényi 1983], ordinary people had to 'tip' doctors to get a bed in a hospital or have an operation in a timely manner, though the cadres went to special clinics and hospitals where tipping was illegal, where the best qualified doctors worked, and where patients had their private rooms. So the services were free for those who could afford to pay for them but were quite expensive for those in the lower income brackets. It is also true that income inequalities were low and the great distributive system in a way 'corrected' for artificially low income inequalities. The great distributive systems operated as fringe benefits, which benefited those whose contribution to society was

appreciated more by the authorities, who set wages and determined access to services provided by the great distributive systems. This was *not* a welfare system as we normally understand it. It was a workfare system, a system of fringe benefits. To put it very simply: while in capitalist welfare systems income inequalities are higher before redistribution and somewhat lower after redistribution, in socialist redistributive systems income inequality appears to be low, but actual social inequalities are higher if we take into account what people receive from the great distributive system. As I put it in my 1978 article: while in market economies the market creates inequalities and redistribution moderates those inequalities, in redistributive economies redistribution creates inequalities and markets moderate them.

Kornai's theory of the 'prematurely born welfare state' had negative policy implications. From the theory it follows that the overgrown welfare state should be cut back – and that is what post-communist societies did, which resulted in a deepening of the split between the poor and the rich. Yet the task, following my theory, should have been to *create* a capitalist welfare state from the socialist workfare state. It is not simply true that the former socialist societies spend too much on welfare. Both the Czech Republic and Hungary spend, for instance, less per capita than Spain or Greece. What is true is that they do not spend it wisely, since the logic of the socialist workfare state still survived: even those who could afford to purchase such services on the market or private insurance are funded from taxpayers' money. Reform of the great distributive system is indeed needed, however the main aim is not to cut back expenditure on health care and education, but to redistribute it from the rich to the poor, rather than the other way around.

Let me make a final point about mixed economies and the elective affinity between forms of economic integration and

property rights. It is far from obvious that the purer the economic systems are, the better they work. It is far from obvious that clearly defined private property rights work best with unregulated free markets. The capitalist world economy experienced its fastest growth with the lowest income inequalities when, at least in continental Europe, substantial sectors of the economy (even some sectors of industry) were publicly owned and managed and when government implemented quite extensive interventions into the workings of capital markets. The performance of core capitalist economies after substantial privatisation and deregulation of markets was underwhelming and nowhere near the growth rates of the 1950s and 1960s while the incomes (and wealth) of the top deciles exploded in comparison with the incomes at the bottom of the society. As I am writing this review, in March 2009, governments around the world have already spent 11 trillion USD of taxpayer money (about 1500 USD for every individual on this globe, including those living in poor African or Asian countries) to bail out the private sector. It looks like private firms in the absence of strict government regulations can also have 'soft budget' constraints. It is not inconceivable that a large proportion of the banking sector has to be nationalised to rescue the world from a crisis, which could be worse without massive state intervention than the 1929–1933 Great Depression was. At least at the moment when I am writing this review it looks like a mix of public and private ownership, planning and markets are not only possible, but may be necessary for the survival of capitalism. Capitalism and free markets have to be defended by smart states from capitalism, from *laissez faire*. This reads like some sort of 'third way' to me.

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Stephan Haggard – Robert Kaufman: *Development, Democracy, and Welfare States: Latin America, East Asia, and Eastern Europe*

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Development, Democracy, and Welfare States: Latin America, East Asia, and Eastern Europe represents a multi-level and multi-dimensional comparison of welfare-state formation in developing and formerly communist countries in Latin America, East Asia, and